 Legislation - Gen

6 February 1984
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MEMORANDUM FOR: DD/OP/SP

STAT

FROM: [redacted]
Legislation Division
Office of Legislative Liaison

SUBJECT: Fiscal Year 1985 Budget Excerpts

Attached for your information are the relevant portion of the Fiscal Year 1985 budget dealing with federal personnel. As reported in the press, the budget seeks modified retirement COLA's, a high-five retirement benefits formula, and increased employee retirement contributions. Additionally, the budget anticipates federal employee health benefits program reforms and a 3.5 percent pay raise for civilian personnel.

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[redacted]

Attachments

cc: C/LEG/OLL

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budget OF THE UNITED STATES GOVERNMENT FY 1985

TABLE OF CONTENTS

Approved For Release 2008/12/02 : CIA-RDP95B00895R000200050025-2

(from the President's Budget Message)

program aimed at the root causes of Africa's economic problems.

Although now less than 2% of the budget, international programs are critical to American world leadership and to the success of our foreign policy.

Civil service retirement.—There is growing recognition that civil service retirement has far more generous benefits and is much more costly than retirement programs in the private sector or in State and local governments. Accordingly, the administration continues its strong support of the civil service reform proposals advanced in last year's budget. In 1985, the administration will focus its legislative effort on three of those proposals, in modified form: cost-of-living adjustment (COLA) reform, a high 5-year salary average for the benefit formula, and increased employee and agency retirement contributions.

GI bill rate increase.—The budget proposes legislation to provide a 15% increase in the rates of educational assistance and special training allowances to GI bill trainees and disabled veterans receiving vocational rehabilitation assistance, effective January 1985. The increase will offset increased costs since GI bill benefits were last raised in 1981. It will provide an increase in monthly education benefit checks to 544,000 veterans and their dependents and survivors.

CONTINUING REFORM OF OUR FEDERAL SYSTEM

The overall efficiency of Government in the United States can also be improved by a more rational sorting out of governmental responsibilities among the various levels of government in our Federal system—Federal, State, and local—and by eliminating or limiting overlap and duplication.

In 1981, the Congress responded to my proposals by consolidating 57 categorical programs into nine block grants. In 1982, a block grant was created for job training in the Jobs Training Partnership Act.

The administration is improving the management of intergovernmental assistance by providing State and local elected officials with greater opportunity to express their views on proposed Federal development and assistance actions before final decisions are made. Under Executive Order 12372, Intergovernmental Review of Federal Programs, which I signed in July 1982, Federal agencies must consult with State and local elected officials early in the assistance decision process and make every effort to accommodate their views. The Order also encourages the simplification of State planning requirements imposed by Federal law, and allows for the substituthe wages of such persons for the first three years of employment (the percentage declines by 10 points in the fourth year and each year thereafter); an increase of 50 percent in the regular investment tax credit for investment in equipment; a 10 percent investment tax credit for new construction and reconstruction of buildings; and continued availability of tax-exempt bond financing beyond the 1986 sunset date for small issue bonds. These incentives, which generally will remain fully in effect for 20 years and be phased out over the succeeding four years, are estimated to reduce receipts by $0.1 billion in 1985, $0.4 billion in 1986, and $0.8 billion in 1987.

Tax treatment of health insurance premiums.—Under current law, compensation paid in cash is fully taxable for both social security and income tax purposes, while compensation in the form of employer-paid health insurance premiums is nontaxable. The administration proposes that effective January 1, 1985, employees be required to pay social security and income taxes on employer-paid health insurance premiums in excess of $175 per month or $2,100 per year for a family plan, and $70 per month or $840 per year for a single plan. Employer-paid health insurance premiums below these amounts still will be excluded from taxation. The $175 and $70 amounts will be indexed to rise with inflation. This proposal is estimated to increase receipts by $3.9 billion in 1985, $6.5 billion in 1986, and $8.0 billion in 1987.

Changes in contributions to civil service retirement (CSR).—Currently, employees contribute 7% of wages and salaries to CSR, employing agencies contribute 7%, and the general fund of the Federal Government contributes 50% of the remaining cost. The administration is proposing several reforms that would reduce the cost of CSR, and increase contributions to the fund. These changes, which are estimated to increase governmental receipts by $0.7 billion in 1985, $1.4 billion in 1986, and $1.5 billion in 1987, include the following:

- *Increase employee contributions.*—The administration's proposal increases employee contributions (including District of Columbia employees who are under CSR) from 7% of wages and salaries to 8% effective October 1984, and to 9% effective October 1985.
- *Increase the District of Columbia (D.C.) employer contribution.*—Matching the proposed contribution by D.C. employees, the administration's proposal increases the D.C. Government contribution from the current 7% to 8% effective October 1984, and to 9% effective October 1985. A corresponding increase in the contribution of Federal employing agencies is proposed; however, these employer contributions are shown

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on the outlay side of the budget and do not affect budget receipts.[5]

Extension of Federal/State unemployment insurance coverage to railroad employment.—Railroad employment is the only sector not covered by the regular Federal/State unemployment insurance system. The separate Railroad Sickness and Unemployment Insurance Fund (RSUI), which is financed by payroll taxes paid by rail employers, has been insolvent for a number of years.

In the past, when contributions have been insufficient to pay benefits, RSUI has borrowed from the rail pension fund. Even though RSUI will not be permitted to borrow from the pension fund after 1985, and the Railroad Retirement Revenue Act of 1983 increased RSUI contributions and established a separate debt repayment tax, it is estimated that the RSUI debt to the rail pension fund will grow to nearly $1 billion by the end of 1985.

The administration proposes to extend regular Federal/State unemployment insurance coverage to railroad employment. Under this proposal rail employment will be covered under Federal and State unemployment insurance tax laws effective January 1, 1985. Existing RSUI contributions and the special debt repayment tax will remain in place to finance sickness payments and to ensure that all debt to the rail pension fund is repaid. This proposal is estimated to increase receipts by $0.1 billion in each year, 1985–1987.

Taxation of Foreign Sales Corporation.—Under present law, taxes on a portion of a company's income from U.S. exports sold through a Domestic International Sales Corporation (DISC) can be deferred. The administration proposes to replace the current DISC provisions with a new system of taxing export sales income that is intended to preserve the competitiveness of U.S. exports while addressing concerns expressed by other General Agreement on Tariff and Trade (GATT) members. This provision is estimated to reduce receipts by a negligible amount in 1985 and 1986, and to increase receipts by $0.1 billion in 1987.

Withholding on U.S. real estate gains of foreign individuals.—The administration proposes to withhold taxes on gains realized by foreign individuals on the sale of U.S. real property. It is estimated that this proposal will increase receipts by $0.1 billion in 1985 and negligible amounts in subsequent years.

Change in the taxation of Trusts for Investment in Mortgages (TIMs).—Changes in the tax laws necessary to permit the develop-

[5] The administration proposes to increase the contributions of the Postal Service by the same amount. Contributions of the Postal Service to CSR are shown on the outlay side of the budget and do not affect budget receipts.

NATIONAL NEED: HEALTH—Continued

(Functional code 550; in millions of dollars)

Major missions and programs	1983 actual	1984 estimate	1985 estimate	1986 estimate	1987 estimate
OUTLAYS					
Health care services:					
Medicaid:					
Existing law	18,985	20,237	23,196	25,045	27,392
Proposed legislation	....	....	−1,067	−1,117	−1,154
Health block grants:					
Existing law	1,273	1,313	1,347	1,353	1,388
Proposed legislation	....	....	76	198	206
Federal employees' health benefits:					
Existing law	1,019	1,309	1,339	1,554	1,756
Proposed legislation	....	....	....	−240	−328
Other health care services:					
Existing law	1,760	1,788	1,663	1,429	1,427
Proposed legislation	....	−1	−4	−6	−6
Subtotal, health care services	23,037	24,647	26,550	28,217	30,681
Health research:					
National Institutes of Health research	3,555	3,987	4,296	4,440	4,529
Other research programs	418	447	491	504	510
Subtotal, health research	3,973	4,434	4,787	4,944	5,039
Education and training of the health care work force:					
Research training	194	205	208	216	220
Clinical training	325	200	169	117	120
Other	59	36	33	18	18
Subtotal, education and training of the health care work force	578	442	410	351	358
Consumer and occupational health and safety:					
Consumer safety:					
Existing law	720	769	795	798	797
Proposed legislation	....	....	....	−5	−9
Occupational safety and health	346	373	373	375	380
Subtotal, consumer and occupational health and safety	1,066	1,143	1,168	1,168	1,168
Total, outlays	**28,655**	**30,665**	**32,916**	**34,680**	**37,246**
ADDENDUM					
Off-budget Federal entity:					
Federal Financing Bank:					
Health care services:					
Budget authority	12	10	3	1	....
Outlays	−14	*	−7	−10	−11

*$500 thousand or less

[1] The large increase in 1984 budget authority over that in 1983 is due to a technical change in the appropriations language for 1984 and beyond.

Federal employees health benefits.—The budget includes savings from the administration's proposal to reform the Federal employees' health benefits (FEHB) program.

FEHB is the world's largest, multiple-choice health plan. Since Federal employees pay a share of the cost of the FEHB program and have many plan choices available to them, competitive market forces help to restrain FEHB cost increases.

In 1983, for example, the average cost of health benefit plans offered by private-sector FEHB carriers increased by over 20%. After Federal employees made health plan selections for the year, however, the actual increase in costs was only 4%.

The administration's FEHB reform legislation would build on the competitive features of the FEHB program:

- The Federal Government's contribution for FEHB would no longer be based on the average premiums of the six largest plans in the program, but would be based instead on a broader measure of changes in cost.
- The current 75% limit on the Federal contribution to the cost of any employee's health benefits would be dropped. If an employee chose a plan with a cost lower than the Federal contribution, he or she would be entitled to a rebate of the difference. This would increase the incentives for employees to select low-cost plans.
- A wider range of plans would be allowed to participate, increasing the number of choices available to employees and sharpening competitive forces.
- Off-budget entities (such as the Postal Service) would be required to pay the Federal Government their fair share of the cost of health benefits provided to their annuitants.

Taken together, these measures are expected to reduce outlays for the FEHB program by 15% below current levels, or about $240 million in 1986.

Other health care services.—Legislation will be proposed to assist Federally-funded health maintenance organizations in competing with other health care providers by removing unnecessary Federal requirements.

For 1985, the administration is requesting $49 million in budget authority for the direct Federal subsidy for the care of District of Columbia residents at St. Elizabeths Hospital. This request is a reduction of $19 million from 1984 and represents the third year of a 10-year phasedown of direct Federal subsidies for these residents. In 1984, the District of Columbia will place in the community 200 nursing home patients and 89 drug and alcohol patients from the hospital, which both reduces the hospital's operating costs and complies with a Federal District Court order to place specified patients in settings less restrictive than St. Elizabeths Hospital. Legislation will also be proposed to establish a corporation to administer the hospital and other public mental health services provided to District of Columbia residents. This proposal and the phasedown of direct Federal subsidies for St. Elizabeths Hospital will make Federal policy with regard to the District of Columbia consistent with the Federal relationship to other States and jurisdictions.

from all sources, the Corporation has a growing deficit that is expected to reach $622 million by the end of 1985 under current law. The budget reflects the administration's request that the Congress approve an increase in the single-employer premium to a level sufficient to cover projected claims and amortize the current deficit over a reasonable period of time. The administration also supports legislation to revise the insurance program for single-employer plans to prevent unwarranted assignment to the Corporation of liabilities for unfunded benefits.

Federal employee retirement and disability.—There are a number of employee retirement and disability programs in the legislative, judicial, and executive branches of the Federal Government. The largest program is civil service retirement and disability. Beginning in this budget, payments to retired military personnel, previously classified in national defense, are included in income security.

Civilian retirement and disability programs.—Benefits are paid to former employees, and their survivors, who meet eligibility requirements based on age and length of service. Currently, full retirement benefits begin at age 55 for employees with 30 years of service. Benefit levels are based on the employee's three highest salary years, and are indexed to the consumer price index (CPI). Current workers and their employing agencies each contribute 7% of wages toward retirement costs. The remainder—about 50% of total costs—is paid by taxpayers through annual Treasury payments to the civil service retirement fund. This retirement system is separate from the social security system. However, new Federal employees hired after December 31, 1983 are covered under a combination of civil service retirement and social security. Under existing law, in 1985 an estimated 2.0 million retirees and survivors will receive payments totaling an estimated $23.6 billion in outlays.

The administration continues its strong support of civil service retirement reforms proposed in the 1984 budget. In 1985, the administration will focus its legislative effort on three proposals: cost-of-living adjustment (COLA) reform, a high 5-year salary average for the benefit formula, and increased employee and agency retirement contributions.

- *Cost-of-living adjustments (COLAs).*—A set of proposals would change the way civil service annuities are increased to reflect changes in the cost of living. The payment date for the next COLA increase would be shifted from June 1984 to January 1985, the CPI measurement period would be adjusted accordingly, and subsequent COLA increases would be paid in January of each year, as proposed in both the Senate and House versions of reconciliation legislation pending in the 98th Congress. The 1982 Reconciliation Act provision for a minimum 3.3% COLA in 1985 for retirees under age 62 would be eliminated. Beginning in 1986, the civil service retirement COLA would be limited to the lesser of the increase in Federal white collar pay or the CPI. This proposal is similar to a provision of the recently enacted Social Security Amendments of 1983. Finally, civil service retirement COLAs would be limited to 55% of regular COLAs on the amount of annuities that exceed $10,000 in 1985. The $10,000 level would be adjusted for inflation in future years.

- *Base annuity calculations on the retiree's highest five years of earnings, instead of the highest three.*—Prior to 1970, a period of relatively low inflation, the formula for computing annuities was based on the average of an employee's five highest salary years; since then the three highest salary years have been used. Employees now eligible for retirement or within three years of retirement eligibility would not be affected.
- *Increase employee and agency contributions for retirement.*—Although retirement costs have skyrocketed, the portion withheld from Federal employees' salaries has remained constant at 7% since 1969. The budget proposes to increase the employee contribution to 8% in 1985 and 9% in 1986. Agency contributions for retirement would also increase by equal amounts. The increase would apply to all Federal agencies and off-budget entities, including the Postal Service and the District of Columbia government, for employees who participate in the civil service retirement system.

The budget also proposes changes to Federal civilian retirement that are consistent with enacted reforms in social security. These include deleting the guaranteed minimum benefit for future annuitants and phasing out special benefits for adult students. In addition, new D.C. government employees hired after September 30, 1984 would not be eligible for coverage under civil service retirement and employee life and health insurance.

In 1985, the total reform package would increase receipts by $0.9 billion, and would reduce outlays by $0.4 billion.

Military retirement.—Benefits are also paid to former military personnel and their survivors. It is estimated that there will be 1.5 million military retirees and survivors in 1985 receiving a total of $17.6 billion in outlays under current law. Normal retirement eligibility is attained at 20 years of service. The initial benefit is 2.5% of final basic pay per year of service. For personnel entering after September 1980, the average of the member's highest three years basic pay will be used instead of final basic pay. Benefits are indexed to the CPI. Consistent with legislation for civil service retirement, the budget proposes to shift the payment date for cost-of-living adjustments for military retirement to January of each year. This proposal would save an estimated $0.3 billion in 1985 outlays. Military personnel also make contributions to and are eligible for social security.

The financing of military retired pay has been changed in this budget. Through 1984, retirement benefits were financed by a charge to the Department of Defense, and were included in the national defense function. Beginning in 1985 a newly created trust fund will make the benefit payments, and this will be included in the income security function. The new trust fund will be financed from charges to the Defense budget for the estimated cost of future retirement benefits being currently earned by active military personnel, along with payments from the general fund for the cost of retirement benefits earned by personnel who are already retired.

The establishment of this new trust fund will shift the funding of military pensions to a basis more comparable to most Federal civilian pensions. The new treatment of military retired pay substantially affects the figures for the income security function. For 1985, the income security function includes $27.3 billion in budget authority and $17.3 billion in outlays for military retirement. Comparable levels of budget authority and outlays for 1983 and 1984 are shown in parentheses in the budget authority and outlays table. In addition, the introduction to Part 5 provides a more detailed explanation of these changes.

Federal employees workers' compensation.—The Department of Labor provides tax-free cash and medical benefits to Federal employees or their survivors for job-related injuries, illnesses, or deaths. About 46,000 workers with long-term disabilities, or their survivors, will receive monthly payments in 1984. As a result of increased efforts to return recipients to work and to remove those no longer eligible from the rolls, estimated 1985 recipient levels are unchanged from 1984. Consistent with proposed legislation for civil service retirement, the budget proposes to shift payment of the cost-of-living adjustment from April 1985 to January 1986, with subsequent COLA's to be payable in January of each year.

Unemployment compensation.—About 97% of wage and salaried employment in the United States is covered by unemployment compensation programs that pay benefits to individuals who are temporarily out of work and are searching for jobs. Based on the economic assumptions described in Part 2, an estimated average of 3.0 million workers per week will receive unemployment benefits during 1984 and 2.8 million workers in 1985. Outlays are estimated to decrease from $20.7 billion in 1984 to $20.1 billion in 1985 due to a decline in the projected average unemployment rate from 8.0% in fiscal year 1984 to 7.6% in 1985.

ALLOWANCES

The budget includes allowances to cover certain forms of budgetary transactions that are expected to occur, but that are not reflected in the program details shown in the preceding functions. When these transactions actually take place, they are reported as outlays or receipts for the appropriate agencies and functions rather than as allowances. For this reason, allowances for completed years are always zero.

Three allowances are included in the budget: civilian agency pay raises, increased employing agency payments for employee retirement, and allowances for contingencies.

ALLOWANCES

(Functional code 920, in millions of dollars)

Program	1983 actual	1984 estimate	1985 estimate	1986 estimate	1987 estimate
BUDGET AUTHORITY					
Civilian agency pay raises			446	3,071	5,217
Increased employing agency payments for employee retirement (proposed legislation):					
Department of Defense			229	487	516
Civilian agencies			280	595	630
Allowances for contingencies:					
Relatively uncontrollable programs					
Other requirements					
Total, budget authority			**954**	**4,153**	**6,363**
OUTLAYS					
Civilian agency pay raises			430	2,968	5,134
Increased employing agency payments for employee retirement (proposed legislation):					
Department of Defense			229	487	516
Civilian agencies			280	595	630
Allowances for contingencies:					
Relatively uncontrollable programs					
Other requirements					
Total, outlays			**938**	**4,050**	**6,280**

Civilian agency pay raises.—This allowance covers the costs of future civilian agency pay raises, including increases for Coast Guard military personnel. Two other pay raise allowances are included in the national defense function.

This allowance includes an assumed pay increase for civilian personnel of 3.5% and a pay increase for the Coast Guard military personnel of 5.5%, both effective in January of 1985. The President's final decision on the 1985 civilian pay increase will be made after he reviews the recommendations of his pay agent and the recommendations of the Advisory Committee on Federal Pay, as provided for by law. The pay raise allowance includes amounts for 1986 and 1987 that are based on the assumption that Federal civilian employees will receive the same average percentage pay increase as private sector workers.

Increased employing agency payments for employee retirement.—The administration is proposing reforms of Federal employee retirement programs. One of the proposed reforms is an increase in the contribution that Federal employees make toward their own retirement, from the current 7% of salary to 8% in 1985 and 9% in 1986, with a matching increase in contributions by employing agencies. This allowance is the amount necessary to finance the higher employing agency payments. The allowance includes the amount of the increased contribution both by civilian agencies and by the Department of Defense. Upon enactment of the administration's proposal, the allowance amounts will be distributed to individual agencies. The administration's retirement reform proposals are discussed in more detail in the income security function.

Allowances for contingencies.—The Congressional Budget Act of 1974 requires that the budget include two specific allowances for unanticipated spending or savings in relatively uncontrollable programs (such as social security) and in discretionary programs.

The estimates for each of these contingency allowances are zero for all years. The contingency allowance for relatively uncontrollable programs is estimated to be zero because the chance of these outlays being lower than the estimates is as great as the chance of being higher. The contingency allowance for other requirements is also assumed to be zero, with probable increases being offset by anticipated decreases.

Allowances account for estimated net outlays of $0.9 billion in 1985.

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